

32

Tax Pointers for Investors in Mutual Funds

Mutual-fund investments relieve you of the responsibility of making daily investment decisions for securities actively traded or affected by changing market conditions.

Mutual funds are either closed or open end.

Closed-end funds. A closed-end fund is a regular corporation that invests in securities but has issued a fixed number of shares that trade publicly like shares of any other company listed on the stock exchange. The daily price of its shares may be below or above the net value of its investment portfolio. Dividend income from a closed-end company is reported as regular dividends (see Chapter 4) and a sale of stock is treated as a regular sale of stock, as explained in Chapter 5.

Open-end funds. These are more popular than closed-end funds. The value and number of shares in the portfolio of the fund change daily on the purchase and redemption of shares. The more complicated tax treatment of open-end funds is discussed in this chapter.

Investing in Mutual Funds	32.1
Money-Market Mutual Funds	32.2
Timing Your Investment	32.3
Reinvestment Plans	32.4
Reporting Mutual-Fund Distributions	32.5
Tax-Exempt Bond Funds	32.6
Fund Expenses	32.7
Tax Credits From Mutual Funds	32.8
Redemptions and Exchanges of Fund Shares	32.9
Comparison of Basis Methods	32.10

See ¶

¶32.1 Investing in Mutual Funds

A mutual fund is a professionally managed pool of individual investors' contributions invested in a variety of securities. Funds are designed and marketed to meet different investor objectives. Money-market mutual funds allow investors to earn a return based on swings in the short-term money market. Income funds invest in either stocks paying high current dividends or bonds paying interest. Growth funds invest in securities that are expected to appreciate over the long term. Some aggressive growth funds invest in small, developing companies with short track records. Other growth funds invest primarily in established firms. International funds invest in stocks of companies outside the United States. Sector funds specialize in specific industries, such as utilities, gold, or high technology companies.

With research, try to find a fund that matches your investment objectives. Check the fund's performance over a substantial period of from five to 10 years. Keep in mind that yields fluctuate and are not guaranteed. In funds other than money markets (¶32.2), the value per share also fluctuates. Gain or loss may be realized when you redeem shares in growth or income mutual funds. Also consider the rate at which a fund turns over its assets. A fund with a high turnover rate will realize frequent capital gains and losses, increasing the likelihood that capital gain distributions will be short term rather than long term. Short-term capital gain distributions are taxed as ordinary income dividends. Long-term capital gain distributions are subject to the rules for long-term capital gains.

Compare sales charges and redemption fees, if any, before you buy. No-load funds do not have a sales charge. Financial sections of major newspapers list prices of mutual-fund offerings. A no-load fund has the same purchase price and redemption price for fund shares; different prices for purchases and redemptions indicate a sales charge. Funds available through a broker may have a charge for commissions.

¶32.2 Money-Market Mutual Funds

A money-market mutual-fund portfolio will generally include U.S. government obligations, CDs of major commercial banks, bankers acceptances, and commercial paper of prime-rated firms. Investors should check each fund's charges because they differ.

Yields, which change daily, are not guaranteed. Investments are not federally insured. Some state-chartered banks, however, offer money-market funds insured by a state insurance fund.

Gains and losses are generally not realized in money-market funds; shares are redeemed for exactly what you paid (usually \$1 per share) plus accrued interest. Some funds offer limited checking privileges.

To compare yields, check newspaper financial sections that periodically list the yields of both taxable and tax-exempt money-market mutual funds. To increase yields, some funds temporarily waive a portion of fees and absorb expenses. Also check minimum investment requirements; some top-yielding funds require a substantial minimum balance that may be as high as \$25,000.

Tax-free money funds. These funds invest in short-term notes of state and local governments issued in anticipation of tax receipts, bond sales, and other revenues, and in "project notes" issued by local entities and backed by the federal government. The interest paid by these funds is exempt from federal tax. The yields are lower than those of taxable funds, and are attractive only if they provide greater after-tax returns than similar taxable funds. These funds may offer check-writing privileges.

Investors in certain states may be able to earn interest that is exempt from state and local, as well as federal, tax.

A tax-free interest return may also be available through unit investment trusts holding tax-exempt state and municipal bonds. These trusts mature in a specified number of years or as called.

¶32.3 Timing Your Investment

You may buy a tax liability if you invest in a mutual fund which has already realized significant capital gains during the year. If you invest near the end of the year and the fund shortly thereafter makes a large year-end capital gain distribution, you will in effect have to pay tax on the return of your recently invested money.

On the "record date" for determining which shareholders receive the fund's dividends and capital gain distributions, the value of the fund's shares drops by the amount of the distributions. If you buy just before that, the higher cost for your shares will be offset by the distributions you receive, but you will have to pay tax on the distributions. On the other hand, because you paid the higher pre-distribution price, your higher basis will reduce any capital gain on a later sale, or increase any capital loss.

If you want to limit your current tax and forego the basis increase, postpone your investment until after the record date for distributions. By that time, the value per share which determines the price will have been reduced by the capital gain distribution. Before investing, you may be able to find out from the fund when distributions for the year are expected; investment publications showing the distribution dates for the previous year also may be consulted.

¶32.4 Reinvestment Plans

Funds allow you to reinvest dividends and capital gain distributions from the fund in new fund shares instead of receiving cash. You report such distributions as if you received them in cash. Form 1099-DIV sent to you by a fund reports the gross amount of taxable distributions that you must report on Schedule B. A key to Form 1099-DIV is on the next page.

Keep track of reinvested distributions. If you reinvest your mutual-fund distributions instead of taking them in cash, keep a record of the distributions and of the shares purchased with the reinvestment. The reinvested distributions are considered your cost basis for the acquired shares. You need a record of reinvestments to figure your cost when you sell your shares; *see* ¶32.9 for calculating gain on the sale of mutual-fund shares.

¶32.5 Reporting Mutual-Fund Distributions

Mutual-fund distributions are reported to you and the IRS by the fund on Form 1099-DIV or substitute statement. Distributions which you reinvested to acquire additional shares are reported and taxed in the same way as distributions which are actually paid out to you.

The Form 1099-DIV from your fund may include several types of dividends and other distributions. The gross amount shown in Box 1a must be reported on your return. The Box 1a total includes ordinary dividends from Box 1b, capital gain distributions from Box 1c, nontaxable return of capital distributions from Box 1d, and in the case of a non-publicly offered fund, your share of fund expenses from Box 1e. *Dividends that you reinvested instead of receiving in cash are included in Box 1a.*

A guide to the different distributions, and how you report them, is shown in the “Key to Reporting Mutual-Fund Distributions” on the next page.

¶32.6 Tax-Exempt Bond Funds

Dividend income from a tax-exempt bond fund is generally tax free, but capital gain distributions are taxable. Exempt dividends are not shown by the fund on 1099-DIV, but are reported separately by the

fund. You report exempt interest on Line 8b of Form 1040. The amount on Line 8b is not taxable, but if you receive Social Security benefits, the amount may affect the amount of taxable benefits; *see* ¶34.3.

Capital gain distributions are shown on Form 1099-DIV and must be reported on your return.

When you redeem your shares in a tax-exempt bond fund or exchange the fund shares for other shares in a different fund, you realize taxable capital gain or deductible loss.

If you received exempt-interest dividends on mutual-fund shares held for six months or less and sold those shares at a loss, the amount of your loss is reduced by the exempt interest dividend. To reflect this adjustment, you increase the sales price reported on line 1, column (d) of Schedule D by the loss not allowed. Report the balance as a short-term capital loss.

EXAMPLE

In January 1996, you bought a mutual-fund share for \$40. In February 1996, the mutual fund paid a \$5 dividend from tax-exempt interest, which is not taxable to you. In March 1996, you sold the share for \$34. If it were not for the tax-exempt dividend, your loss would be \$6 (\$40 – \$34). However, you may deduct only \$1, the part of the loss that exceeds the exempt-interest dividend (\$6 – \$5). On Schedule D, column (d), increase the sales price from \$34 to \$39 (the \$5 nondeductible). You may deduct \$1 as a short-term capital loss.

¶32.7 Fund Expenses

If you own shares in a *publicly offered* mutual fund, you do not pay 1996 tax on your share of the fund expenses. There should be no entry in Box 1e of the Form 1099-DIV. However, expenses of a *non-publicly offered* fund are included in Box 1e of Form 1099-DIV and must be reported as a taxable dividend, even though the amount has not actually been distributed to you. An offsetting deduction may be claimed on Schedule A as a miscellaneous itemized deduction, subject to the 2% adjusted gross income floor; *see* ¶19.24.

For purposes of figuring gain or loss when you redeem or exchange shares, load charges (sales fees) paid after October 3, 1989, on the purchase of the shares may not be treated as part of your cost if you held the shares for 90 days or less and then reinvested the sales proceeds at a reduced load charge; *see* Example 3 at ¶32.9.



Key To Reporting Mutual-Fund Distributions

Type of Distribution	Shown by the Fund in	Where You Report
Gross dividends. (This amount includes ordinary dividends, capital gain distributions, and return of capital distributions.)	Box 1a	If the total dividends received by you from all of your investments is \$400 or less, ignore this box and enter information from boxes 1b to 1e. If your total dividends exceed \$400, enter this amount on Schedule B, Line 5, or Line 9 of Form 1040A.
Ordinary dividends. (This includes your share of fund earnings from dividends, interest, and short-term gains.)	Box 1b, Form 1099-DIV	If <i>all</i> of your mutual-fund distributions from Forms 1099-DIV are ordinary dividends, you may report them on either Form 1040 or Form 1040A. If this total plus your other dividends from all sources is \$400 or less, enter them on Line 9 of Form 1040 or Line 9 of Form 1040A. If more than \$400, you should have already entered the amount on Line 5, Schedule B. <i>Note:</i> If you also have capital gain or nontaxable distributions from Form 1099-DIV, you may <i>not</i> use Form 1040A to report the ordinary dividends; all of your mutual-fund distributions must be reported on Form 1040 and, if necessary, Schedule B.
Capital gain distributions. (This represents your share of long-term gains realized by a fund on sales made from its portfolio. You treat the amount as long term, even if you held the fund shares for less than a year.)	Box 1c, Form 1099-DIV	Capital gain distributions, if any, are included in the amount on Line 5 of Schedule B if the gross distributions from all mutual-funds plus your other dividends exceed \$400. On Line 7 of Schedule B, the capital gain distributions are subtracted from the Line 6 total. Also, enter the capital gain distributions as long-term capital gain on Line 14 of Schedule D, or on Line 13 of Form 1040 if you do not need to use Schedule D for other transactions. If not completing Schedule B, enter the capital gain distributions on Line 14 of Schedule D or Line 13 of Form 1040. However, even if you do not need Schedule D for other transactions, you should use Schedule D to report 1996 mutual-fund capital gain distributions if your taxable income exceeds \$96,900 if married filing jointly or a qualifying widow(er); \$58,150 if single; \$83,050 if head of household; or \$48,450 if married filing separately. In such a case, using Schedule D allows you to take advantage of the 28% maximum tax on long-term capital gains; see ¶15.2.
Return of capital distributions (nontaxable)	Box 1d, 1099-DIV	Return of capital distributions if any are included on Line 5 of Schedule B and then subtracted from the other dividends on Line 8. Thus, the return of capital distributions is not included in taxable income. However, if your basis for your shares has been reduced to zero by return of capital gain distributions, report additional nontaxable distributions as a long-term or short-term capital gain on Schedule D, depending on how long you held the shares. If your total dividends from all sources is less than \$400, you do not have to report them on your return unless your basis has been reduced to zero. If you have received return of capital distributions exceeding basis, report any additional distributions as capital gain on Schedule D.
Exempt-interest dividends	A separate statement; not included on Form 1099-DIV. This will be sent to you within 60 days after the close of the fund's taxable year.	For informational purposes only, report along with other tax-exempt interest on Line 8b of Form 1040 or Form 1040A.
Undistributed capital gains	Undistributed gains shown on Form 2439, Line 1 Tax paid by fund shown on Form 2439, Line 2	Report the undistributed gains on Schedule D, Line 12. To get a tax credit for the tax paid by the fund, enter the tax on Line 57 of Form 1040. Increase the basis of your mutual-fund shares by the excess of the undistributed gains included on Schedule D over the tax credit claimed on Line 57 of Form 1040.
Funds expenses from non-publicly offered fund	Box 1e, Form 1099-DIV	If you itemize, the expenses are itemized deductions, subject to the 2% adjusted gross income floor (¶19.1).
Foreign taxes	Box 3, Form 1099-DIV. The country imposing the tax is shown in Box 4.	The foreign taxes may be claimed as a tax credit on Form 1116 or as an itemized deduction on Schedule A of Form 1040; see ¶36.14.

¶32.8 Tax Credits From Mutual Funds

Undistributed capital gains. Some mutual funds retain their long-term capital gains and pay capital gains tax on those amounts. Even though not actually received by you, you include as a capital gain distribution on your return the amount of the undistributed capital gain allocated to you by the fund. If the mutual fund paid a tax on the undistributed capital gain, you are entitled to a tax credit.

To claim the credit, check the Form 2439 sent to you by your fund, which lists your share of undistributed capital gain and the amount of tax paid on it by the fund. Enter your share of the tax the fund paid on this gain on Line 57 of Form 1040, and check the box for Form 2439. Attach Copy B of Form 2439 to your return to support your tax credit. Increase the basis of your stock by the excess of the undistributed capital gain over the amount of tax paid by the mutual fund, as reported on Form 2439.

Dividends from foreign investments. The dividends are taxable, but you may be able to claim a foreign tax credit (on Form 1116) or a deduction on Schedule A for your share of the fund's foreign taxes.

In Box 3 of Form 1099-DIV, the fund will report your share of the foreign taxes paid, and in Box 4, the name of the foreign country. The fund should give you instructions for claiming the foreign tax credit or deduction; also see ¶36.14.

¶32.9 Redemptions and Exchanges of Fund Shares

When you ask the fund to redeem all or part of your shares, you have transacted a sale subject to capital gain or loss rules explained in Chapter 5. Exchanges of shares of one fund for shares of another fund within the same fund "family" are treated as sales. If you owned the shares for more than one year, your gain or loss is long term; if you held them for a year or less, your gain or loss is short term. However, if you received a capital gain distribution before selling shares held six months or less at a loss, your loss must be reported as a long-term capital loss to the extent of the capital gain distribution attributable to the sold shares. Any excess loss is reported as a short-term capital loss. This restriction does not apply to dispositions under periodic redemption plans.

EXAMPLE

In June 1996, you bought mutual-fund shares for \$1,000. In August, you received a capital gain distribution of \$50, and you sold the shares for \$850 in September. Instead of reporting a \$150 short-term capital loss (\$1,000 cost – \$850 proceeds), you must report a long-term capital loss of \$50, the amount of the capital gain distribution; the remaining \$100 of the loss is a short-term capital loss.

Holding period of fund shares. You determine your holding period by using the trade dates. The *trade date* is the date on which you contract to buy or redeem the mutual-fund shares. Do not confuse the trade date with the settlement date, which is the date by which the mutual-fund shares must be delivered and payment must be made. Most mutual funds will show the trade date on your purchase and redemption confirmation statements.

Your holding period starts on the day after the day you bought the shares. (The day you bought the shares is the trade date.) This same date of each succeeding month is the start of a new month regardless of the number of days in the month before. The day you dispose of the shares (trade date) is also part of your holding period.

BASIS OF REDEEMED SHARES

To figure gain or loss, you need to know the basis per share. Generally, your basis is the purchase price of the shares, including shares acquired by reinvesting, plus commission or load charges.

If your shares in a mutual fund were acquired at different times, you need to know the basis of the particular shares you are selling in order to determine gain or loss. There are several methods of identifying which shares you are selling. The specific identification method allows you to select exactly which shares are being sold and is an advantage if you want to designate shares that will produce a particular gain or loss result. You may elect to average the cost basis of all of your shares under either a single-category or double-category method. Finally, a first-in, first-out (FIFO) method applies if you do not specifically identify the shares or make an averaging election. See the chart on page 461 for details on these identification methods.



Keeping Track of Cost Basis

Keep confirmation statements for purchases of shares as well as a record of distributions that are automatically reinvested in your account. These will show the cost basis for your shares. Your basis is increased by amounts reported to you by the fund on Form 2439, representing the difference between your share of undistributed capital gains which you were required to report as income and your share of the tax paid by the fund on undistributed gains. Your basis is reduced by nontaxable dividends that are a return of your investment. Keep copies of Form 2439 and information returns showing nontaxable dividends.

Basis does not include load charges (sales fees) paid after October 3, 1989, on the purchase of mutual-fund shares if you held the shares for 90 days or less and then exchanged them for shares in a different fund in the same family of funds at a reduced load charge; see Example 3 on the next page.

EXAMPLES

1. In 1988, you bought 100 shares of a mutual fund for \$10 a share. In 1991, you bought another 200 shares for \$11 a share, and in 1992, another 500 shares for \$15 a share. In 1996, you sell 130 shares at \$20 a share, but do not specifically identify the shares being sold. Under the IRS FIFO method, you are treated as having first sold the original 100 shares from 1988, then 30 of the shares bought in 1991. Your basis for the sold shares is \$1,330:

100 shares from 1988 costing \$10 each	\$1,000
30 shares from 1991 costing \$11 each	<u>330</u>
	\$1,330

Your taxable gain is \$1,270 (\$2,600 sales price less \$1,330 basis). Had you specifically designated shares from the most recent lot, which cost you more, you would have reduced the taxable gain. For example, if you had given the fund written instructions to sell 130 of the 500 shares that you bought in 1992 at \$15 per share, your basis on the sale under the specific identification method would be \$1,950 ($130 \times \15) instead of \$1,330. Gain would be reduced from \$1,270 to \$650 (\$2,600 sales price less \$1,950 basis).

2. Hall sold by phone part of his holdings in two mutual funds acquired over a number of years without specifying the particular shares being sold. On his return, Hall claimed a net long-term capital loss of about \$2,400 using a LIFO method (last-in, first-out). However, using the FIFO method, the IRS held that he had a long-term capital gain of \$163,000. In the Tax Court, Hall argued that the specific identification rule applies only to stock certificates, not noncertificate shares left on deposit with a mutual fund. The court disagreed. Without specific identification, the IRS FIFO method is reasonable. If good records are kept, you can select the specific shares being sold at the time of sale. You cannot wait until the end of the year to allot specific sales to gain a tax advantage.

What if you give written instructions to a mutual fund that specific shares should be sold, but the fund does not acknowledge this in its written confirmation? Regulations require such a written confirmation within a reasonable time after the sale. However, the Tax Court indicates your written sale identification instructions may be acceptable without a written confirmation.

3. You pay a \$200 load charge on purchasing shares for \$10,000 in Fund A. Within 90 days, you exchange the Fund A shares for Fund B shares. Because Fund A and Fund B are in the same family of funds, the \$200 load charge that would otherwise be due on the purchase of the Fund B shares is waived. For purposes of figuring your gain or loss on the exchange of Fund A shares, your basis is \$10,000, not \$10,200. The disallowed \$200 is added to the basis of the new Fund B shares, provided those shares are held more than 90 days. If the waived load charge on Fund B shares had been \$100, basis for the original Fund A shares would be increased by \$100, the excess of the original \$200 load charge over the amount waived on the reinvestment.

¶32.10 Comparison of Basis Methods

As discussed at ¶32.9, your choice of basis method can have a significant effect on the computation of capital gains and losses when you sell a portion of your shares in a mutual fund. The following example compares the single averaging method to the specific identification and FIFO methods.

Transaction History. Assume that on February 7, 1992, you made an initial investment of \$4,500 for 375 shares in ABC Mutual Fund at \$12 per share. Under the dividend reinvestment plan, you reinvested a \$400 dividend, received in December 1992, for an additional 40 shares at \$10 per share. On June 10, 1993, you bought 350 shares at \$15 per share. In December 1993 you reinvested your dividend, this time for 25 shares at \$12 per share. On September 16, 1994, you bought 200 shares at \$16 per share. In 1994, 1995, 1996, and 1997, you did not reinvest your dividends. On October 11, 1997, you ask ABC Mutual Fund to redeem 200 shares and you receive \$20 per share. The table below illustrates your transactions.

Date	Action	Share Price	No. of Shares	Shares Owned
2/7/92	Invest \$4,500	\$12	375	375
12/19/92	Reinvest \$400 dividend	\$10	40	415
6/10/93	Invest \$5,250	\$15	350	765
12/14/93	Reinvest \$300 dividend	\$12	25	790
9/16/94	Invest \$3,200	\$16	200	990
10/11/97	Redeem \$4,000	\$20	200	790

The following are three different ways to compute the basis of the shares redeemed on October 11, 1997.

Specific identification method. If you identify the shares you sold, you can use the adjusted basis of those shares to figure your gain or loss. You must specify the particular shares to be redeemed at the time of the sale, as well as receive confirmation of your specification in writing within a reasonable time. Depending on your situation, you may want to either maximize or minimize your gain or loss on the sale. Here, you will have a gain regardless of which shares are treated as being sold. Assuming you want to minimize your gain, then you would specify the 200 shares bought at \$16 per share on September 16, 1994, as the shares sold. Since the shares were sold for \$20 per share, the long-term capital gain would be \$4 per share, for a total of \$800 of capital gain (\$4,000 – \$3,200).

FIFO (first-in, first-out). If you do not identify which shares you sold or choose the averaging method, you must use the basis of the shares you acquired first as the basis of the shares sold. Therefore, the oldest shares still available, the February 7, 1992, shares, are considered sold first. Thus, the basis of the 200 shares sold would be \$12 per share. Your long-term capital gain is \$1,600 (\$4,000 – \$2,400).

Average cost (single category). The ABC Mutual Fund may provide you with your average basis (single category) when you make the redemption. If it does not, you may compute the average basis for all shares owned at the time of disposition, regardless of how

long you owned them, including shares acquired with reinvested dividends. The basis and gain is computed as follows: You total the number of shares owned prior to the sale, 990, and total your investment in these shares, which is \$13,650. You divide \$13,650 by 990, which gives an average cost of \$13.79 per share and a total cost of \$2,758 for the 200 shares. Your gain is \$1,242 (\$4,000 – \$2,758). For holding period purposes, the shares sold are considered to be from the earliest lot in 1992, so your gain is long-term capital gain.

Result: The specific identification method gives you the lowest capital gain.



Key to Identifying Mutual-Fund Shares When You Sell

Method—

Tax Effect—

Specific identification of shares sold

If you sell some of your shares that have been left on deposit with an agent for the fund, and you identify the specific lot of shares being sold in your sell order, you can fix profit or loss on the sale, depending on the cost of the shares selected. See Example 1 on page 460. You should give the fund written instructions to sell shares that you bought on a particular date and at a particular price. Ask the fund for a written confirmation that acknowledges your instructions.

FIFO (First-in, first-out)

If you do not specifically identify the sold shares as just discussed, and you do not elect to average cost basis as discussed below, the IRS requires you to compute gain or loss as if shares were sold in the order that you acquired them. If the earliest acquired shares are treated as sold, taxable gain on a current sale will generally be higher than if the specific identification method was used, assuming that your least expensive shares were bought first; see Example 1 on page 460.

Averaging your basis

You may elect to average the cost of shares acquired at different times and prices. The election applies to open-end mutual-fund shares held by an agent, usually a bank, in an account kept for the periodic acquisition or redemption of shares in the particular fund. You still need records of your total basis, but averaging avoids the difficult task of identifying the exact shares being sold. Some funds ease the record-keeping burden by providing to shareholders who have redeemed shares a statement showing their average cost basis under the single-category method.

The single-category method is easier to apply than the double-category method, as explained below. To elect either averaging method, attach a note to your return specifying the chosen method. Once you have elected a method, you must continue to apply the same method for all sales or exchanges of shares in the same fund. However, you may use the specific identification method or the FIFO method, or the other averaging method for shares of other funds in the same “family” of funds. For example, if you own shares in the XYZ Co. growth fund and also in the XYZ Co. bond fund, you may use an averaging method for the bond fund shares and the specific identification method for the growth fund shares.

You can use the average cost basis for sales of shares in one mutual-fund family, and use the specific identification method for sales of shares of other fund families.

If your account includes shares received as a gift that were worth less than the donor’s basis at the time of the gift, you may elect either averaging method for that account only if you include a statement on your return that the basis used in applying the method to the gift shares will be the value of the shares when you received them. This treatment also applies to gift shares you receive after the election.

Single-category averaging

You figure the average cost per share by dividing your total basis for all shares in the account by the number of shares. For example, if you bought 100 shares of a fund in 1991 at \$20 per share and another 100 shares in 1992 at \$30 per share, your average basis per share is \$25 (\$5,000 total cost ÷ 200 shares). If you sell 50 shares in 1996 for \$35 a share, your basis for the sold shares is \$1,250 (50 × \$25 average basis) and your gain on the sale is \$500 (\$1,750 sales proceeds less \$1,250 basis). For purposes of determining whether gain or loss is long-term or short-term capital gain, you are treated as having sold shares in the order you acquired them (first-in, first-out).

Double-category averaging

You have to separate your account shares into a long-term category for shares held more than one year and a short-term category for shares held one year or less. You figure the average cost per share in each category by dividing the total basis for all shares in that category by the number of shares in that category. You may specify to the agent handling share transactions the category from which you are selling. If you do not so specify, the long-term shares are deemed to have been sold first. If the number of shares sold exceeds the number in the long-term class, the excess shares are charged to the short-term class.